**Office of Thrift Supervision**
Department of the Treasury
1700 G Street, N.W., Washington, DC 20552 • (202) 906-6173

Montrice Godard Yakimov
*Managing Director, Compliance and Consumer Protection*

November 16, 2009

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

SUBJECT: Comments on Proposed Amendments to Regulation Z
Docket No. R-1370

Dear Ms. Johnson:

The Office of Thrift Supervision (OTS) has reviewed the Federal Reserve Board's proposed amendments to Regulation Z to implement provisions of the Credit Card Accountability Responsibility and Disclosure Act of 2009 (Credit CARD Act). We are encouraged by the aspects of the October 21, 2009 proposed rule that provide consumers with greater protection and transparency in their use of credit cards. To provide assistance with this effort, we have enclosed our comments on the proposed rule.

If you have any questions regarding our comments, please contact either April Breslaw, Consumer Regulations Director at (202) 906-6989 or Suzanne McQueen, Consumer Regulations Analyst at (202) 906-6459 or Richard Bennett, Senior Compliance Counsel at (202) 906-7409.

Sincerely,

Montrice Godard Yakimov

Montrice G. Yakimov

Enclosure

Office of Thrift Supervision
Staff Commentary on Proposed Regulation Z Amendments
FRB Docket R-1370

The Office of Thrift Supervision (OTS) is taking this opportunity to comment on the proposal by the Board of Governors of the Federal Reserve System (Board) to amend Regulation Z,[1] which implements the Truth in Lending Act (TILA),[2] as amended by the Credit Card Accountability Responsibility and Disclosure Act of 2009 (Credit CARD Act).[3] We support efforts to strengthen Regulation Z to provide better protection and transparency for consumers who use credit cards. However, as explained in more detail below, OTS recommends several adjustments to the proposal.

*I. Ability to repay.*

Pursuant to the Credit CARD Act, TILA has been amended to require credit card issuers to consider a consumer's ability to repay before opening an account or increasing the credit limit applicable to such an account.[4] Proposed § 226.51(a) implements these restrictions by requiring issuers to have reasonable procedures to evaluate whether a consumer will be able to make the required minimum monthly payment, considering the consumer's income or assets and current obligations. OTS has several concerns about this approach.

First, we believe that the focus on the minimum payment is misplaced. Even if this payment is designed to amortize the debt as safety and soundness guidance requires,[5] it is likely to be a relatively small dollar amount. As the Board's examples reflect, such a payment is likely to be only a few hundred dollars on a $10,000 credit line.[6] On a smaller line, the minimum payment may well be less than $100 per month. As most consumers have the resources to remit these small payments, the approach taken by the proposed rule renders the statutory requirement almost meaningless.

Moreover, focusing on whether a consumer is able to make the minimum payment encourages a lending strategy that is likely to yield lower credit quality. Based on our supervisory experience, credit card portfolios with higher concentrations of borrowers who only remit minimum required payments generally have slower turnover rates and present higher risk.[7] Consequently, OTS strongly encourages the Board to reconsider its approach. We suggest that the statutory provisions be interpreted to require consideration of a consumer's ability to repay the entire debt, including required fees and interest over a reasonable period of time, such as a year. It is our understanding that some large issuers not only follow this strategy now, they

1 Truth in Lending, Proposed Rule (Regulation Z Proposal), 74 Fed. Reg. 54124, Oct. 21, 2009, available at: http://edocket.access.gpo.gov/2009/pdf/E9-23733.pdf.
2 15 U.S.C. § 1601 et seq.
3 Public Law 111–24, 123 Stat. 1734, May 22, 2009, available at: http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_public_laws&docid=f:publ024.pdf.
4 Credit CARD Act § 109, adding new § 150 to TILA, 15 U.S.C. § 1665e.
5 See OTS Examination Handbook, Asset Quality, Credit Cards, p. 218.3
6 See 74 Fed. Reg. at 54160.
7 OTS Examination Handbook, Asset Quality, Credit Cards, p. 218.24

consider whether a consumer has the ability to repay a multiple of the credit line. This approach lays the groundwork for increasing the credit line in the future.

With respect to the factors that an issuer should consider in determining repayment ability, it has been our supervisory experience that the most important predictors of whether a cardholder will repay new obligations is whether the cardholder: (1) has a consistent source of income; and (2) has repaid existing obligations in a timely manner. OTS therefore recommends that the Board require that issuers consider both when determining whether new or additional credit should be extended. Repayment history, either with that issuer or with other creditors, could be evaluated by examining a borrower's credit score, credit report, or other data, consistent with proposed comment 51(a)(1).

Although the proposed rule does not require that issuers verify the information used to determine repayment ability, the Board has asked for comment on whether verification should be required.[8] Based on our supervisory experience, verification is important in two contexts. First, where a consumer has little or no credit history, an issuer is not likely to be able to use the consumer's past performance to determine whether credit should be extended. In such a situation, verification of other information may help an issuer determine whether to grant credit. Separately, where an issuer is considering granting a relatively large line of credit (*e.g.*, over $10,000) verification of information provided by the borrower may offer important confirmation that the borrower has the resources to repay the credit granted.

Aside from these two situations, it may be adequate for creditors to assess whether the information provided by an applicant/borrower is credible, rather than requiring them to verify its precise accuracy. For example, automated systems could be used to determine whether the income reported by a borrower is consistent with the level of income associated with the borrower's occupation or the income of most borrowers who live in the geographic area in which the borrower resides. Where self reported income is outside the norm, verification could be undertaken. This approach is consistent with the Board's observation that verification may be necessary, "when the information supplied by the applicant is inconsistent with the data the card issuers already have or are able to gather on the consumer or when the risk in the amount of the credit line warrants such verification."[9]

*II. Fees that exceed 25 percent of the credit provided to a cardholder.*

Aside from fees for late payment, over-the-limit transactions, and insufficient funds ("exempt fees"), the Credit CARD Act prohibits issuers from assessing other "non-exempt" fees that exceed 25 percent of the credit available during the first year in which a credit card account is opened.[10] If the 25 percent threshold is reached, the statute prohibits issuers from charging additional non-exempt fees to the account. Notably, the statute begins by limiting the total amount of fees that can be assessed. In doing so, it does not focus on the amount of fees that have been charged to the account. Such fees are not mentioned until after the 25 percent threshold has been reached. As noted above, the statutory consequence of meeting the 25 percent aggregate fee threshold is that only exempt fees may be charged to the account for the rest of the

8 See 74 Fed. Reg. at 54161.
9 Id.
10 See Credit CARD Act § 105, amending § 127 of the TILA.

first year that it is open. Notably, the Board has used its authority to expand this requirement to prohibit issuers that have met the 25 percent threshold from assessing non-exempt fees by any means.[11]

However, proposed § 226.52(a)(i)[12] implements the 25 percent threshold differently than the Credit CARD Act requires. Under the proposed rule, issuers do not face fee limitations until they *charge the account* more than 25 percent of the initial credit provided. If they reach that threshold, they are prohibited from assessing non-exempt fees by any means. Under this formulation, an issuer that charges a $74 account opening fee to a card with a $300 limit would not be restricted from separately requiring the borrower to pay "application," "program," "maintenance," or other questionable fees in cash or through charges to another credit card. OTS strongly recommends that the Board revise proposed § 226.52(a)(i) to prohibit issuers from assessing - by any means - fees that exceed 25 percent of the credit provided to a cardholder. Such a revision would prevent issuers from evading the 25 percent threshold by charging some dubious fees to an account and requiring the separate payment of others.

In this context, we note that a "security deposit" should not be treated as a fee. For clarity, we recommend that the Board define such a deposit as funds transferred by a consumer to an issuer at account opening that are pledged as security for a credit card account. Under this formulation, an amount charged to an account would not be a "security deposit" because such a charge would not reflect funds provided by the borrower. Proposed comment 52(a)(2)-3 reaches the same conclusion by a different route. However, consistent with comment 52(a)(2)-3, the amount of a true security deposit, *i.e.*, one based on funds provided by the borrower, would not be limited by the rule. OTS agrees that there is no compelling policy reason to limit the amount of a true security deposit because the borrower is entitled to reclaim it if the credit line is repaid. We note that when a consumer has separate funds at stake, it may provide an incentive for responsible credit behavior. Such an arrangement can therefore provide a means for consumers to build a positive credit history.

*III. Right to reject or "opt out" of changes.*

*A. Opt out*

Although consumers are generally provided with a right to reject significant changes in terms, the Board explains several times that it has interpreted the Credit CARD Act so that this right does not to apply to annual percentage rate (APR) increases.[13] The Board has taken this position because the Credit CARD Act and the proposed amendments to Regulation Z prohibit issuers from raising rates on an "outstanding balance" unless specific exceptions apply.[14] For these purposes, an "outstanding balance" is the balance outstanding as of the 14th day after notice of an APR increase is provided.[15] Thus, once the proposed amendments to Regulation Z take effect in February 2010, consumers will be protected from rate increases on such balances whether they take action to reject them, or not. In fact, the Board observed that "notifying

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[11] See proposed § 226.52(a)(ii).
[12] 74 Fed. Reg. at 54226.
[13] See, e.g., 74 Fed. Reg. at 54154.
[14] See Credit CARD Act §101 amending TILA § 171 and proposed § 226.55 of Regulation Z.
[15] See proposed § 226.55(b)(3)(ii).

consumers that they have a right to reject a rate increase could be misleading insofar as it could imply that a consumer who does so will receive some additional degree of protection (such as protection against increases in the rate that applies to future transactions)."[16]

This conclusion seems appropriate with respect to rate increases on outstanding balances. Yet, proposed form G-20 muddies the issue by stating, "You have a right to opt out of these changes."[17] If this language is intended to address state opt out requirements, that should be explained. As currently drafted, neither the proposed rule or preamble draw a clear distinction between the right to reject proposed rate increases for outstanding balances - which the Board views as potentially misleading - and the right to opt out of such rate increases - which the Board apparently views as necessary.

If an opt out is required under state law, it presents the same risk of misleading consumers as the right to reject rate increases on outstanding balances does. Consequently, if the Board determines that such an opt out must be accommodated, form G-20 and the rule text which explains the disclosure requirements illustrated by the form,[18] should require issuers to provide consumers with explanatory information. Where an opt out is provided, issuers should be required to inform consumers if it relates only to outstanding balances and not to future transactions. Where applicable, consumers should be informed that a rate increase will apply after the effective date stated in the notice if they continue to use the card – whether they opt out, or not. Absent such information, consumers may be misled into believing that by opting out, they have avoided the rate increase that the issuer plans to apply to future transactions.

*B. Rejecting proposed rate increases on future transactions.*

The "advance notice" exception to the prohibition against raising rates on outstanding balances, shows that issuers will have a mechanism to raise rates for transactions that occur more than 14 days after notice of an APR increase is provided.[19] However, the Board seems to have exempted issuers from providing consumers with the opportunity to reject such increases.[20]

Although some consumers may recognize that they are free to stop doing business with an issuer that proposes to raise the rate that applies to future transactions, others may not. In addition, while issuers may not be willing to allow all consumers to forego an APR increase for future transactions, they may be willing to do so to avoid losing low risk customers.[21] Moreover,

16 See 74 Fed. Reg. at 54154.
17 See 74 Fed. Reg. at 54251.
18 See proposed § 226.9(c)(2)(iv)(A)(3).
19 See proposed § 226.55(b)(3).
20 See proposed § 226.9(c)(2)(iv)(B).
21 In the past, issuers raised rates primarily as a penalty or in response to deterioration in a borrower's credit profile. However, recent research indicates that issuers have changed their business model. When rates are raised, a wider range of customers have been affected, not just those with blemished credit histories. See *Federal Reserve Board Senior Loan Officer Opinion Survey: October 2009* (finding that 50% of the institutions surveyed expected to increase rates for prime borrowers as a result of the enactment of the Credit CARD Act), available at: http://www.federalreserve.gov/boarddocs/SnLoanSurvey/200911/ . As issuers have adopted this new strategy for managing their revenues, it is not appropriate to assume that they will routinely terminate credit privileges for cardholders who reject such increases. This is because a significant number of these consumers have demonstrated the ability and willingness to repay their obligations.

the Credit CARD Act provides that "each notice" of an increase in interest rate shall include information about this right, not just notices that relate to changes in other significant terms.[22]

For both practical and legal reasons, OTS recommends that the Board revise the proposed rule to require issuers to provide a right to reject rate increases that apply to future transactions. Proposed form G-20, which serves as a sample notice of a rate increase, should be revised accordingly. Most importantly, it should explain whether consumers who reject a future rate increase will be permitted to continue to use their cards, and if so, what rates will apply. Where an issuer is only willing to provide on-going credit privileges if an increased rate applies to future transactions, the issuer should be required to explain that a consumer can only avoid such an increase by ceasing to use the affected account 14 days after notice of the increase has been provided.

*C. Rejecting proposed fee increases.*

Proposed form G-21 illustrates how consumers may be notified of fee increases.[23] Pursuant to the disclosure requirements contained elsewhere in the proposed rule,[24] form G-21 succinctly states that the consumer has the right to reject the proposed fee increases. It also indicates how the consumer may contact the issuer to exercise this right. Where applicable, it informs the consumer that the issuer will terminate the consumer's ability to use the card for new transactions if the consumer exercises the right of rejection. However, neither form G-21 nor the accompanying rule text[25] provide adequate information for consumers who reject a new or increased fee, but are permitted to continue to use their cards. In such cases, issuers that are not willing to waive a proposed fee increase should be required to notify consumers that even if they reject such a change, it will still apply after the effective date stated in the notice. Absent such information, consumers may be misled into believing that by rejecting the change, they have avoided the new or increased fee that the issuer plans to apply in the future.

*D. The effective date for changes in significant terms should be clarified.*

Under the proposed rule, issuers will be required to notify consumers of the specific date on which changes to significant terms will become effective.[26] However, the section of the rule which discusses the information that must be included in such notices does not clarify that the effective date cannot occur less than 14 days after the notice has been sent. To find this requirement, issuers must refer to the "advance notice" exception to the prohibition against raising rates – which is located in a different part of the rule.[27] OTS suggests that the change in terms notice provisions of proposed § 226.9(c) include the 14 day requirement and reference the advance notice exception set forth in § 226.55(b)(3).

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22 See Credit CARD Act § 101(a) amending TILA § 127, which discusses the "right to cancel" that the Board has interpreted as a "right to reject" significant changes.
23 See 74 Fed. Reg. at 54251.
24 See proposed § 226.9(c)(2)(iv)(B).
25 Id.
26 See proposed § 226.9(c)(2)(iv)(4).
27 See proposed § 226.55(b)(3).

*IV. Equal Credit Opportunity Act (ECOA) protection from reprisal should not be weakened.*

Where a consumer's transaction exceeds the credit limit, proposed §226.56(b) would prohibit a creditor from assessing an over-the-limit fee unless the consumer has affirmatively consented to the creditor's payment of the transaction. Moreover, a creditor that assesses over-the limit fees would be prohibited by proposed §226.56(j)(3) from conditioning the amount of credit provided upon receipt of consumer consent to the payment of over-the-limit transactions. This approach is consistent with ECOA and Regulation B, which prohibit a creditor from discriminating against an applicant because the applicant has in good faith exercised any right under TILA.[28]

However, ECOA and Regulation B prohibit more than reprisal by lowering the amount of credit granted if the consumer opts out. For example, they prohibit retaliation by making any term or condition of granting credit less favorable if the consumers opts out.[29] Despite this, the proposed rules on over-the-limit transactions do not address these longstanding requirements. Creditors may interpret this silence to mean that it is permissible to discriminate against consumers who do not consent to the payment of over-the-limit transactions by offering them less favorable terms, such as charging them a higher interest rate or a higher annual fee. OTS therefore recommends that the Board clarify that a creditor may not discriminate against an applicant in any of its terms or in any other respect because the applicant has in good faith exercised the right to opt out of a creditor's payment of over-the-limit transactions.

*V. Tangible items that cannot be used to induce a college student to open a credit card.*

Pursuant to the Credit CARD Act and the proposed rule, card issuers may not offer college students any tangible item to induce them to apply for a credit card, if such an offer is made on or near an institution of higher education or at an event sponsored by such an institution.[30] The Board's proposed comment 57(c)-1 clarifies that a "tangible item" includes any physical item, such as a gift card, a t-shirt, or a magazine subscription. As cash is a tangible item, it should be included in this list. This approach would prevent institutions from offering cash as an incentive once they are no longer permitted to offer other tangible items as inducements to apply for credit cards.

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[28] ECOA and Regulation B prohibit discrimination based on the good faith exercise of any right afforded under the Consumer Credit Protection Act. 15 U.S.C. § 1691(a)(3); 12 C.F.R. § 202.2(z). TILA is title I of the Consumer Credit Protection Act. 12 C.F.R § 205.2(c).

[29] See 12 C.F.R. § 202.1. Regulation B defines discrimination against an applicant to mean treating an applicant less favorably than other applicants. 12 C.F.R. § 202.2(n).

[30] See Credit CARD Act § 304 amending TILA § 140 and proposed § 226.57 of Regulation Z.